Stretching Investments till the End

The fundamental things retirees need to do in order to for investments to last until their death are: good planning, modest spending, keeping reserves for large purchases and emergencies, disciplined investment allocations and conservative investment choices. I worked 33 years and need to have my investments last well over 48 years if either I or my wife live as long as some of our parents. It was an absolute necessity for me to understand what would be required. I'll describe the most important things I have done over the years. They are conservative, something that has served me well over my past 23 years of retirement—with lots more to go.

The main element has been to make a new retirement plan every year. I can't over emphasize that point to those who think they can make a plan one year and simply increase last year's spending by inflation each subsequent year. A new plan lets me account for many things besides using the actual investment balances each year instead of where they were theoretically supposed to be. I can change my perspective of future returns, inflation and tax rates—all of which are key assumptions in any projection of the future. I can also account for changes or new events that I may see ahead that I didn't before. This leads to the points I want to make about conservative spending.

Of course, it's important to make modest investment withdrawals each year, hopefully with increases to offset inflation. The best way to do this is to use a retirement planning program at about the same time each year. There is a good program for this on www.analyzenow.com. Staying with the resulting budget may require restrained spending compared to past spending. Forget the Joneses. Plan to live within your means, not theirs. This may mean anything from finding ways to lower utility bills to downsizing your home.

It really helps to consider saving for large ticket items before purchase rather than buying such items on credit. This requires a "Replacement Reserve." The discipline for calculating the size of replacement reserves is not that hard. It's used by all competent home owners associations. There are both articles and a program on www.analyznow.com that show how to account for the numbers. The difficult part is the needed restraint to delay spending the money.

At some point in retirement, almost everyone is confronted with a relative who needs money. Early in retirement it may be retired parents who have run short of funds. Later it may be one of your own children that lost a job or breadwinning partner. Try to rationalize what might be required for modest support, not necessarily what they say they "need."

Many retirees do not have a plan. They simply spend all of their after-tax income. That may be conservative very late in retirement, but it is likely to result in overspending early in retirement. At least recognize that you can only spend part of fixed pensions and annuities in order to save something to offset inflation later. I have found that it's helpful to those without a formal plan to limit the spending contribution from a fixed payment pension or annuity to the after-tax payment times their age divided by100. Save the remainder and invest it.

If you have a qualified savings account like an IRA, it's probably OK to spend most of the after-tax required-minimum-distribution (RMD) after age 70 ½ because those amounts are based on making an average retiree's portfolio last about ten years past the point where 50% of the people in their age group have passed away. RMD divisors are approximately life expectancies plus 10 years, or the joint and last survivor life expectancies for couple where one spouse is ten years younger than the other.

But what kind of withdrawals from a qualified account can you make after 59 ½ and before age 70 ½? You might consider withdrawing a fraction of last year's ending balance by dividing that balance by a factor equal to 27 plus the number of years until you will reach 70. So a 65 year old would get the amount to withdraw by dividing last year's ending balance by 32 (27 plus 5).

If you keep some reserves for emergencies, either annual replanning or conservative rules of thumb will preserve some investments till your dying day. If your returns are a little better than inflation, your spending will keep up with inflation in most years although there may be years to cut back when the markets tank. Reserve funds can help bridge difficult times.

Postponing the start of Social Security may be the best protection for troubled times. Waiting until at least the Full-Retirement-Age (about 66-67) not only provides the main wage earner more money but most often the lower earning spouse as well. This income is inflation adjusted, a rarity for regular income producing investments. Although the payments may end up being reduced a little because of government debt growth, there is far less risk than that from almost any other source of retirement income. You can use the Social Security calculator on www.analyzenow.com to determine the best age to start Social Security in your case.

Then there's the allocation of investments. I use a conservative age related formula. Every year I check to see if I should rebalance to my target allocations of stocks and fixed-income investments. I rebalance whenever my stocks get out of the range of a minimum or maximum for my age. The minimum percentage is 100 minus my age. The maximum is ten percent higher. Generally, I haven't had to rebalance only about every other year.

I choose conservative securities within those allocations. My stocks are all in broad, low cost index funds, such as ones based on the S&P 500 index. My investment real estate is largely in REIT indexes. They count as stocks. My fixed income investments are mostly AAA rated bonds, not bond funds. I hold the bonds to maturity so as not to lose any principal. They are laddered (mature in different years) and are all from different sources. I can do this because I have built significant savings. People with less saving can invest in bond funds, but they then lose principal if they have to withdraw in periods of high interest rates.

Part of my fixed income investments are laddered immediate annuities with inflation adjustments from highly rated insurers. By laddered, I mean that they have been purchased several years apart. This is particularly important right now because interest rates are low, and low interest rates translate into smaller payments. Also, as we grow older, the insurance companies know they will be making payments for a fewer number of years, so the payments will be larger. You don't ever want to get to the point where the only fixed income investments that you have are immediate annuities because you'll need significantly more cash in some years than the annuities will provide—and you'll end up being a borrower again.

The ultra safe investments I have are Treasury Inflation Protected Securities (TIPS) and Savings I Bonds. Right now, both have very low base interest payments, but they both have inflation adjustments that actually end up providing more growth than even moderately risky bonds. I buy the TIPS at regular government auctions in my Roth IRA. Otherwise, I would not get a full inflation adjustment because of taxes. Because I only buy them at auctions, I have no broker's fees. TIPS report gains every year while with Savings I Bonds, you only pay the taxes when cashed. That means that you can have very long periods of tax-deferred growth with Savings I Bonds. I also buy Savings I Bonds for gifts to my children and grandchildren.

Remember, the secret to making your investments last are good planning, modest spending, keeping reserves for large purchases and emergencies, disciplined investment allocations and conservative investment choices.

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